Ten Years After the Crisis, What Next?

Guy Foster, Head of Research at Brewin Dolphin, looks at some of the lessons learned from the credit crunch and what we can expect from the global economy in the years ahead

It is ten years since the collapse of Lehman Brothers sparked the global financial crisis. The recovery from the turmoil that followed has been slower than many hoped for or anticipated.

However, a decade after the tumultuous events of 2008, major central banks are finally starting to reverse the 'easy money' policies that they implemented to nurse ailing economies back to health.

The question for investors now, is what is going to drive economic growth over the coming years?

Demographic Shift

One thing we can be certain about is that demographics are going to have a significant impact: the workforce expansion rate is an important determinant of overall economic growth.

In many western countries, including the UK and Europe, we are going to see a higher old-age-dependency ratio (the number of elderly people as a share of those of working age). That implies lower economic growth.

As the productive labour force declines, economic output will slow. Fiscal balances will also deteriorate as tax revenues decline and spending on pensions, healthcare and other welfare programs for the elderly increase.

Inflation should return as older people move from a period of saving to spending. However, with weaker growth, central bankers will find it difficult to raise interest rates, likely leading to an unsatisfactory combination of rising prices and lower growth. >

In the near to medium term we expect interest rates in Europe to remain close to zero and in the UK to go no higher than 1.5%.

Productivity Puzzle

An ageing population also has implications for productivity. Since the crisis, weak productivity and investment growth have been a source of deep concern for western economies, particularly the UK. Looking ahead, an ageing workforce could make the productivity dip difficult to reverse, as older workers tend to be less productive.

Irrespective of the impact of Brexit, for countries like the UK that are rapidly ageing, a 'doldrums economy' of low economic and productivity growth looks likely to be the new normal.

Elsewhere, demographic patterns look more favourable, including in the US, although its more positive position has a lot to do with immigration which may be under threat. Things look even better in some emerging markets, particularly India.

India should overtake China as the most populous country in the world over the next 10 years – the result of China's long imposed but now abandoned 'one child policy'.

China's Leadership

Despite this, the tilt towards China is still likely to dominate as the big macro theme of the next ten years. A milestone was passed in the last decade as China made a bigger contribution to global growth than the US. Looking ahead, China has its sights set on attaining technological leadership by 2025.

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The plan is as broad as it is deep, with plans to focus on specific industries whilst also upgrading the entire manufacturing sector. Critically it represents an intention to move up the value chain from the low-cost production that China of old was famous for, instead championing cutting-edge businesses, processes, products and services.

Traditionally, emerging markets have struggled to compete with richer countries as rising wages mean they lose competitiveness in manufactured goods. The 'Made in China 2025 strategy', the blueprint for China's bid for technological leadership, attempts to overcome this challenge.

China has four times as many people, earning less than a sixth as much as the average American, giving it the opportunity to become the largest economy in the world by an enormous factor.

Technological Supremacy

The US administration is aware of what is at stake over the next decade and has demonstrated that it considers the US's status as global technological leader as worthy of protection. Earlier this year the US Commerce Department's Bureau of Economic Analysis attempted to quantify the importance of the digital economy to overall US economic growth. It concluded that in 2016, the digital economy, which includes network infrastructure, e-commerce and digital media, accounted for $1.2trn, or 6.5% of US gross domestic product, and 5.9m jobs (3.9% of total US employment).

While those might not sound particularly big numbers, the sector's growth has been truly impressive. In the [years through to] 2016, the digital economy grew at an average annual rate of 5.6%, compared with the 1.5% growth in the economy as a whole.

Not unreasonably, Washington fears that if China takes the lead in artificial intelligence and other digital technologies it will also lose its economic supremacy. We believe this sets the stage for a protracted period of declining economic cooperation between the US and China.

The globalisation of trade had already peaked in 2008 and is likely to retreat somewhat because of a protracted trade cold war. However, we would expect future US administrations to feel they need the support of allies-in-trade to hold back the otherwise irrepressible China.

Innovation Hotspots

We are only just beginning to see the transformative potential of recent technological innovations. Advances in data analytics and genetics are moving us closer to a world of personalised medicine, catering to the individual needs, lifestyle, and >

genetic makeup of each patient. Indeed, developments in big data and machine learning are driving forward personalisation in many aspects of our lives, from shopping to insurance.

Further innovations in the next ten years are likely to result in a change in the drivers of growth within the technology space.

In 2008 Microsoft was the only company in the S&P 500's top ten which would identify as being a technology company. Now it is joined by Apple, Amazon, Facebook and two classes of Alphabet (better known as Google). We expect to see some soul searching amongst regulators about the market power of these entities, many of which seem invulnerable to natural competition.

Their rise has been the result of the growth of internet and mobile platforms which facilitate e-commerce and e-media. The next ten years is likely to be driven by different technology-facilitated themes.

There are many uncertainties about how these will develop but key new industries such as electronic and autonomous vehicles will emerge from developments in all-solid-state batteries, artificial intelligence and 5G mobile communication technology.

Just as the last decade saw the commercialisation of existing internet technology, over the next ten years the ability to 3D print human organs and advances in gene therapy to treat cancers could greatly reduce mortality and suffering amongst patients.

Huge change is also expected in the energy sector. Offshore wind power is likely to be one of the fastest-growing renewable energy sectors as the technology behind it improves and costs of installation fall.

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Traditionally energy-poor Europe is well-placed to benefit from the deployment of offshore floating wind farms, with a large part of the North Sea being of appropriate depth.

"Too Big to Fail"

But what of the banks, the sector that sparked the financial crisis? The fallout from the Lehman bankruptcy highlighted the dangers posed by "too big to fail" financial institutions. So it is ironic that the world's biggest banks have grown even bigger in the decade since. America's domination of the investment bank world has been a major theme since the financial crisis as American banks have won market share at the expense of European rivals, including Barclays and Royal Bank of Scotland.

Globally, banks' capital reserves have increased sharply, meaning they are safer than before the crisis, but margins have been squeezed.

Since the financial crisis all the big banks, with the exception of JPMorgan, have seen their balance sheets shrink, and there aren't any clear signs of that changing. However, we believe there are still attractive opportunities within the sector. After spending many years de-risking its balance sheets and restructuring we believe a bank like Lloyds offers both attractive dividends and the potential for capital returns.

Of course, a lot can and will happen in the next ten years, much of it impossible to foresee. There remain many challenges ahead and, as financial markets enter a new phase, investors will need to be more discerning about which assets they buy. But, in an age where we could see some incredible technological advances, we believe there will remain plenty of opportunities for growth – if you know where to look. ■

Guy will be speaking the 2018 Non-executive Director Retreat, held in association with Brewin Dolphin and EY

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Guy leads Brewin Dolphin's Research team ensuring that a rigorous and exhaustive investment process is employed. He also provides recommendations on tactical investment strategy to Brewin Dolphin's investment managers and strategic recommendations to the group's Asset Allocation Committee.

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